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In the Supreme Court of the United States

OCTOBER TERM, 1973

CASE NO. 73-197

ROBERT R. FRANK, et al.,

Petitioners,

vs.

J. WILLIAM WOLF, et al.,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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COUNTER-STATEMENT OF QUESTIONS PRESENTED

The Petition for Writ of Certiorari filed by Petitioners bears no relation whatsoever to what transpired in the courts below. The only questions properly presented by this Petition and the record below are as follows:

I. WHETHER THE UNITED STATES SUPREME COURT SHOULD EXERCISE ITS DISCRETION BY GRANTING A PETITION FOR WRIT OF CERTIORARI TO DETERMINE WHETHER THE FINDINGS OF FACT OF A TRIAL COURT JUDGE WERE CLEARLY ERRONEOUS PURSUANT TO RULE 52(a), FEDERAL RULES OF CIVIL PROCEDURE.

II. WHETHER THE SUPREME COURT SHOULD EXERCISE ITS DISCRETION BY GRANTING A PETITION FOR WRIT OF CERTIORARI TO DETERMINE WHETHER A TRIAL COURT JUDGE HAS PROPERLY EXERCISED HIS EQUITABLE DISCRETION.

COUNTER-STATEMENT OF THE CASE

Petitioners' statement of the proceedings in the trial court bears no relation to what actually transpired. For this reason, Respondents will briefly recite the facts as found by the trial judge. In doing so, we will quote from the opinion in this cause of the United States Court of Appeals for the Fifth Circuit and make reference to the numerous and detailed findings of fact made by the District Court. These findings of fact are reproduced in their entirety in the Appendix filed by Petitioners with their Petition for Writ of Certiorari at (A. 64). Reference will be made where possible to each particular findings of fact as "F of F". For clarity, the parties are referred to in their capacity in the trial court:

"In early 1969, plaintiff J. William Wolf began discussing with defendants Robert R. Frank and Jack H. Stein the possibility of his investing in IGB, a Florida corporation with its principal place of business in Florida. (F of F2 and 3). Defendants Frank, Stein, and Roberts organized IGB with the intention of making it a bank holding company, and they served at all relevant times as officers and directors of IGB. (F of F2 and 4). Plaintiff repeatedly met with defendants, in various combinations, to discuss IGB. (F of F6). Prior to plaintiffs' initial purchase, defendants Stein and Frank represented to plaintiff that they were going to allow not more than fifteen of their friends to purchase shares in IGB before making a proposed public offering. They represented that everyone would pay $2.00 cash per share and that there would be no free stock or fringe benefits. (F of F7). In reliance upon these and other representations concerning (1) an application by IGB to the Federal Reserve Board for approval as a bank holding company, (2) the acquisition plans of IGB, and (3) the progress of registration of IGB shares with the Florida Securities Commission, plaintiffs purchased 37,500 shares of IGB stock for $75,000.00 between July 28, 1969 and October 8, 1969. No registration statement was then in effect as to those securities. (F of F8).

As early as July 24, 1969, prior to the initial purchase of IGB stock, plaintiff began inquiring among his friends about resales to them of the IGB stock that was to be purchased. During the six-month period beginning in late July, 1969,

plaintiffs sold at least 23,000 of their 37,500 shares to approximately fourteen persons in various parts of the United States at prices ranging from $2.00 to $5.00 per share. In these transactions plaintiffs realized a total of $95,000.00, some $20,000 more than they had paid for all their IGB stock. (F of F9).

In fact, an application for approval as a bank holding company was never filed on behalf of IGB. Furthermore, defendants did not pay $2.00 cash per share when they acquired their own stock interest in IGB. First, in September, 1969, defendants exchanged 19,826 shares of stock in the National Industrial Bank [hereinafter NIB] with IGB for 346,995 newly issued shares of IGB stock, pursuant to an exchange ratio computed by defendant Roberts. (F of F10). At the exchange value of $2.00 per share, the IGB stock acquired in the exchange by defendants was worth $693,910.00. The NIB stock that the corporation received from defendants in exchange was worth considerably less. It had been purchased by defendants in January, 1968 for $197,260.00, or $10.00 per share, and was selling for $10.00 per share in October, 1969. Second, on January 16, 1970, defendants received 184,935 shares of IGB stock in exchange for non-interest bearing, unsecured promissory notes in the amount of $369,870.00 due in 1973. (F of F10, 11 and 12).

A voting trust agreement reflects that defendants controlled 1,336,391 voting shares of IGB and were at all material times in control of the com-

pany. (F of F17). Although IGB's Certificate of Incorporation requires the directors to fix the value of any property received by the corporation in exchange of stock, this was not done in conjunction with the transfer by defendants of their 19,826 shares of their NIB stock for 346,995 shares of IGB stock [hereinafter the 'NIB-IGB stock exchange']. In that exchange, a ratio of 17½ to 1 was the basis used, and the value of the IGB stock was calculated at its par of $1.00 per share. Under this ratio, defendants received the equivalent of $17.50 per share for their NIB stock. If the transaction had been based on payment of $2.00 per share for the IGB stock, the sum that defendants had represented would be paid and that everyone else did in fact pay, then defendants actually received what amounted to $35.00 per share for their NIB stock, which was worth no more than $10.00 per share. The required valuation was also neglected in connection with the issuance of stock to defendants in exchange for their promissory notes. (F of F13).

At a directors meeting held on January 16, 1970, defendants, acting as directors, elected three additional directors. The new directors, with defendants abstaining, authorized defendants to purchase the aforementioned 184,935 shares of IGB stock by executing noninterest bearing, unsecured notes in the total amount of $369,870. (F of F22 and 23). At the same time that these noninterest bearing and unsecured notes of defendants were outstanding, IGB borrowed greater sums from banks at interest rates varying from 7½ percent

to 9½ percent per annum. Such loans were fully secured by part of the assets of IGB. (F of F18). The newly constituted board of directors, with defendants voting, 'ratified' the NIB-IGB stock exchange and all other actions taken on previous occasions by defendants as directors. (F of F23). No annual or special meeting of stockholders of which plaintiffs received notice was held until January 21, 1971. (F of F21).

Soon after the meeting of January 21, 1971, plaintiffs brought this action both individually and derivatively as stockholders of IGB against defendants. The complaint charged that: (1) misrepresentations, omissions, and acts of defendants constituted a manipulative and deceptive device and contrivance and a scheme and artifice to defraud in connection with the sale of securities of IGB to plaintiffs, all of which was in violation of Rule 10b-5; (2) sale by defendants to plaintiffs of the IGB stock constituted a violation of Section 5 of the Securities Act of 1933, 15 U.S.C. §77e, because no registration covering the securities had been declared effective by the United States Securities and Exchange Commission; (3) defendants committed common-law fraud in connection with plaintiffs' purchase of IGB stock.

Relying on Rekant v. Desser, 5 Cir. 1970, 425 F.2d 872, the District Court found that plaintiffs had established a derivative Rule 10b-5 violation by defendants in that defendants' activities in the NIB-IGB stock exchange constituted a fraudulent issuance of stock to insiders for grossly inade-

quate consideration. The District Court found that the NIB stock was worth $198,260.00 and that therefore defendants paid approximately $.57 per share of IGB stock issued to them, or $1.43 less than the $2.00 per share that defendants represented that they would pay for their IGB purchase. The Court ordered defendants to reimburse IGB $1.43 per share of IGB received in the fraudulent transaction. The District Court also found, however, that plaintiffs were not entitled to individual relief under Rule 10b-5 because they failed to show any actual individual damages in connection with the sale or purchase of IGB stock, since through their own sales of IGB stock they had made a profit of approximately $20,000.00 in addition to the value of the IGB shares they retained.

The District Court relied on Hill York v. American International Franchises, Inc., 5 Cir. 1971, 448 F.2d 680, in finding that defendants had violated Section 5 of the Securities Act of 1933 and in granting the individual plaintiffs the option of rescinding their purchase of 14,000 shares of IGB stock. The Court also held that Section 5 of the 1933 Act did not authorize derivative relief for the corporate entity.

Finally, the District Court found that defendants breached their fiduciary duty on January 16, 1970 by paying for IGB stock with non-interest bearing notes. The Court ordered defendants to pay IGB 7½ percent back-interest on the $369,870.00 note, from January 16, 1970 to the date of the judgment." (A. 3 to A. 8).

POINT I

WHETHER THE UNITED STATES SUPREME COURT SHOULD EXERCISE ITS DISCRETION BY GRANTING A PETITION FOR WRIT OF CERTIORARI TO DETERMINE WHETHER THE FINDINGS OF FACT OF A TRIAL COURT JUDGE WERE CLEARLY ERRONEOUS PURSUANT TO RULE 52(a), FEDERAL RULES OF CIVIL PROCEDURE.

The trial court correctly concluded that the defendants had looted IGB by causing it to fraudulently issue stock to them for a grossly inadequate consideration in connection with the exchange by defendants of 19,826 shares of NIB for 346,955 shares of IGB. The trial court had before it uncontradicted documentary evidence that defendants paid only $10.00 per share or $198,260.00 for the NIB stock for which they received, based on the $2.00 per share that everyone else was paying, $693,910.00 worth of IGB stock. Plaintiffs offered Exhibit 146 at trial which demonstrated that on October of 1969, one month after the exchange, NIB stock was still selling at only $10.00 per share. Based on this evidence, defendants paid only $.57 per share for their IGB stock based on the 17½ to 1 exchange ratio used. To put it another way, although the market value of NIB stock at the time of the exchange was shown to be $10.00 per share, defendants received $35.00 per share for the NIB stock. As the trial judge correctly stated in his findings of fact:

> "Under any measure of value, the NIB stock was greatly overvalued in exchange." (A. 67).

In addition, there was uncontroverted documentary evidence introduced at trial that while the defendants had obtained stock in IGB in return for noninterest bearing unsecured promissory notes, IGB was borrowing from banks greater sums at interest rates varying from 7½ percent to 9½ percent per annum. This was firmly established by the books and records of IGB as well as the notes executed by the defendants. Moreover, the defendants admitted that they obtained the shares of IGB for these noninterest bearing unsecured promissory notes.

In view of the foregoing, it is obvious that the trial judge correctly decided that the defendants had defrauded the company and this Court should clearly not exercise its discretion to determine whether the findings of fact of the trial court judge were clearly erroneous. Not only were they not clearly erroneous, they were the only conclusion that any trier of fact could reach under the circumstances of this case.

POINT II

WHETHER THE SUPREME COURT SHOULD EXERCISE ITS DISCRETION BY GRANTING A PETITION FOR WRIT OF CERTIORARI TO DETERMINE WHETHER A TRIAL COURT JUDGE HAS PROPERLY EXERCISED HIS EQUITABLE DISCRETION.

The case was tried over a period of six days by an experienced trial judge who had previously presided at many sophisticated securities cases. Based on all the facts introduced at trial, it is clear that the trial court properly concluded that the plaintiffs were not barred from recov-

ery by the equitable doctrine of unclean hands. The applicable law was correctly stated by the Fifth Circuit in its opinion below:

> "While the defense of 'unclean hands' is available in securities actions in this Circuit, Kuehnert v. Texstar Corp., 5 Cir. 1969, 412 F.2d 700, its application rests within the sound discretion of the District Court. Whether the defense is allowed should be determined by ascertaining whether the application or non-application of the defense will better promote the objectives of the securities laws by increasing the protection afforded the investing public. Id. The District Court did not abuse its discretion in refusing to bar plaintiffs from maintaining a suit to enforce the requirements of Section 5 of the Securities Act of 1933." (A. 11 to A. 12).

Further, as the Fifth Circuit also pointed out in its opinion:

> "Defendants are purblind to the fact that this is not a case of a brigand seeking to recover his loot. Plaintiffs' actions, alleged to be illegal were in no way involved with the transactions for which the District Court granted derivative relief. Furthermore, although defendants contend that plaintiffs are economic pirates disqualified because of their piracy from representing an innocent corporation, the District Court made no such finding and in fact found that only defendants were picaroons." (A. 15).

The barring of the plaintiffs' recovery, either individually or derivatively, in the case at bar would in no way promote the objectives of the securities laws by increasing the protection afforded to the investing public. All it would accomplish, and all the defendants seek to accomplish, would be to allow the defendants to escape unscathed with their ill-gotten gains. The plaintiffs alleged unclean hands by virtue of resales of stock do not alter the fact that the corporation was defrauded by the defendants in connection with the NIB-IGB exchange and the purchase of stock for notes, or that the defendants violated Section 5 of the Securities Act of 1933 when they sold plaintiffs their IGB stock. Moreover, the plaintiff resales do not even have any bearing at all upon these wrongs and should not prevent their being redressed.

Accordingly, this Court should not grant a Writ of Certiorari to determine whether the trial judge properly exercised his equitable discretion in refusing to apply the defenses of unclean hands and in pari delicto in this particular case. It is apparent that the trial judge's findings in this regard were correct.

We will now deal with each of the purported questions presented in the Petitioners' Brief for the convenience of the Court despite the fact that these questions are not properly presented by this record. Each question will be numbered as it was in the Petitioners' Brief.

I. The Court below did not find nor was it compelled to find that defendant was a "market making dealer who was an insider tipster/tippee." However, even if this was so, the only persons with standing to complain about this would be those who purchased from the plaintiff and not

these defendants. See **Affiliated Ute Citizens v. U.S.**, 408 U.S. 128 (1972). Since plaintiffs did not sell stock to these defendants and had no duty of disclosure to them, this point has no merit.

II. This was an action under the Securities Act of 1933 and the Securities Exchange Act of 1934, both of which are Federal Statutes. Accordingly, no diversity of citizenship had to exist for Federal jurisdiction. However, it should be noted that the trial judge found as a fact that diversity of citizenship did exist. (A. 65). With respect to the amount in controversy, a judgment in the amount of $557,613.56 was entered. No more need be said about this purported question.

III. Relief in this case was not granted under "Federal Corporation Law" but was granted for violations of Section 10b of the Securities Act of 1934 and Rule 10b-5 thereunder. See **Rekant v. Desser,** 425 F.2d 872 (5th Cir. 1970).

IV. Unclean hands and in pari delicto were pled by the defendants. (A. 50 to A. 51). The trial court found as a matter of fact that there was no basis for applying unclean hands or in pari delicto. The United States Court of Appeals for the Fifth Circuit directly considered this question and found it to have been resolved properly below. (A. 10 to A. 12).

V. The plaintiffs pled and proved that they fairly and adequately represented the interest of the other shareholders of IGB. (A. 45). After all, the Court entered a judgment for $557,613.56 in favor of IGB and against the defendants which will inure to the benefit of all the share-

holders of IGB. Under the circumstances, it is laughable for the Petitioner to assert that the plaintiffs did not fairly and adequately represent the interest of the other shareholders of IGB, when this fund has been created for their benefit. It should also be noted that in the trial court defendants moved for a dismissal on these grounds and the court found as a matter of fact and law that the plaintiffs did fairly and adequately represent the other shareholders and the court summarily denied this motion by the defendants.

VI. The District Court did not grant relief beyond the supposed limitations contained in either the Securities Act of 1933 or the Securities Exchange Act of 1934. Contrary to the position of the Petitioners, the District Court did not make the plaintiffs more than whole but rather granted relief to the corporation in a derivative lawsuit brought on behalf of the corporation by the plaintiffs. This recovery was clearly in accordance with the pronouncements of this Court and the Fifth Circuit. See **Superintendent of Insurance v. Bankers Life & Casualty Company,** 404 U.S. 6 (1971); **Rekant v. Desser,** supra.

VII. Petitioners' question here was properly resolved by the United States Court of Appeals for the Fifth Circuit. In addition, it should be noted that the defendants did not plead the statute of limitations as a defense to the 10b-5 actions below. (A. 51). The statute of limitations does not affect subject matter jurisdiction. It does not affect the ability of the court to hear a case, and, accordingly, the failure of defendants to plead the defense below constitutes a waiver of this defense. **Headrick v. Atchison, T & S Ry. Co.,** 180 F.2d 305 (10th Cir. 1950). The Fifth

Circuit's treatment of this argument by the Petitioners is as follows and no further comment is necessary:

> "Defendants nevertheless contend that even though plaintiffs filed this action within the two-year statute of limitations, which defendants argue is applicable under F.S.A. §517.21, plaintiffs are barred because they failed to tender their securities to defendants as required by F.S.A. §517.21. Plaintiffs reply that Florida's three-year statute of limitations for actions brought for relief on the ground of fraud, F.S.A. §95.11, is applicable and that they fall well within that time period.
>
> Defendants' argument misconceives the issue. This suit was maintained in the District Court under Rule 10b-5, not under pendent jurisdiction of a state claim. When applying the forum's statute of limitations to actions brought under the federal securities laws, federal courts borrow only the chronometric aspects and not the procedural or substantive nuances of the law of the forum. We therefore find it unnecessary to determine whether the applicable statute of limitations is the two-year limitation embodied in Section 517.21 or the three-year limitation of Section 95.11 because plaintiffs commenced this action well within either period of limitation. (A. 13).

VIII. Whether the Petitioners' statement of the clearly erroneous rule or the Fifth Circuit's statement of the clearly erroneous rule is adopted, the result is the same. The trial court properly decided all questions of fact below.

The United States Court of Appeals for the Fifth Circuit ruled on these matters within the limits of its scope of review and also decided them properly. Accordingly, there is no need for this Court to take jurisdiction of this matter and the Petition for Writ of Certiorari filed by the Petitioners must be denied.

CONCLUSION

The Petition for Writ of Certiorari does not present any question which should be heard by this Honorable Court. Accordingly, the Petition should be denied.

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CERTIFICATE OF SERVICE

WE HEREBY CERTIFY that a true and correct copy of the foregoing Respondents' Brief in Opposition to Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit was served by mail upon Irving M. Wolff, Esq., Attorney for Petitioners, 916 Biscayne Building, Miami, Florida, 33130, this ____ day of September, 1973.

Of Counsel